(6)

No. 88-2180



# In the Supreme Court of the United States

OCTOBER TERM, 1989

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KANSAS AND MISSOURI, ETC., PETITIONERS

*v.*

KANSAS POWER & LIGHT COMPANY, ET AL.

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT*

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## BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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## QUESTION PRESENTED

Whether the rule of *Hanover Shoe, Inc.* v. *United Shoe Machinery Corp.*, 392 U.S. 481 (1968), and *Illinois Brick Co.* v. *Illinois*, 431 U.S. 720 (1977), precludes proof that a direct purchaser has passed on an overcharge caused by a third party's antitrust violation when the direct purchaser is required by regulation to pass on the full amount of the illegal overcharge to its customers.

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# In the Supreme Court of the United States

OCTOBER TERM, 1989

No. 88-2109

KANSAS AND MISSOURI, ETC., PETITIONERS

*v.*

KANSAS POWER & LIGHT COMPANY, ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT*

## BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is submitted in response to the Court's order inviting the Solicitor General to express the views of the United States.

### STATEMENT

1. Respondents are public utilities that purchased natural gas from a pipeline company for their own use and for delivery to their customers. They and other purchasers from the pipeline sued the pipeline and five natural gas producing entities; respondents alleged that the pipeline and producers had conspired to inflate prices in violation of Section 4 of the Clayton Act, 15 U.S.C. 15. Respondents sought as damages both the amount of the overcharge and lost profits attributable to the decrease in demand for natural gas resulting from the higher prices.

Petitioners Kansas and Missouri subsequently filed suit against the same defendants as *parens patriae* on behalf of residential consumers who had purchased natural gas from the utilities. See 15 U.S.C. 15c.[1] The cases were consolidated.

2. Defendants countered that the utilities lacked standing to bring an antitrust suit because the utilities had passed on any illegal increase in the price of natural gas to their customers, as assertedly required by applicable state regulations and tariffs filed with state utility commissions. Pet. 4. Consequently, defendants argued, it was the customers who bore the entire burden of any antitrust injury.

The utilities moved for partial summary judgment as to this defense, and the district court granted their motions. It noted that in *Hanover Shoe, Inc.* v. *United Shoe Machinery Corp.*, 392 U.S. 481 (1968), this Court held that a direct purchaser is damaged within the meaning of Section 4 of the Clayton Act, 15 U.S.C. 15, to the extent of the overcharge even if it in fact passed on the entire overcharge to its customers. Pet. App. A25-A27. The district court further observed that although *Hanover Shoe* involved the defensive use of a pass-on theory, this Court later held in *Illinois Brick Co.* v. *Illinois*, 431 U.S. 720 (1977), that the offensive use of the pass-on theory (by "indirect" purchasers who seek to prove damages) is also barred. Pet. App. A27.

The district court acknowledged that the extent to which the defendants in this case passed on the allegedly illegal

[1] The residential consumers on whose behalf petitioners sued are not limited to respondents' customers, nor do they include the utilities' residential customers in other states.

Petitioners also sued in a representative capacity on behalf of governmental entities that purchased natural gas from the pipeline. That claim is not at issue here.



overcharge was a disputed factual issue, but it concluded that the pass-on defense would be barred even "if the facts establish that the rate systems governing the utilities permitted a total pass-through of any price increase." Pet. App. A33. Although this Court had suggested that a pass on defense might not be barred when an overcharged buyer has a pre-existing "cost[-]plus" contract for a fixed quantity, *Illinois Brick*, 431 U.S. at 736; see *Hanover Shoe*, 392 U.S. at 494, the district court held that this possible exception did not apply in this case because consumer demand for natural gas is governed neither by a fixed-quantity contract nor by anything resembling its "functional equivalent." Pet. App. A34. Recognizing that the utilities' motions for summary judgment "were, in reality, motions to dismiss the States of Kansas and Missouri in their *parens patriae* capacity," the district court dismissed petitioners' *parens patriae* claims. Pet. App. A38.

In so ruling, the district court relied on *Illinois* v. *Panhandle Eastern Pipe Line Co.*, 839 F.2d 1206 (1988), where a panel of the Seventh Circuit had on "almost identical facts" rejected a similar "pass[-]on" contention. Pet. App. A36. After the district court rendered its decision, the Seventh Circuit granted rehearing en banc in *Panhandle Eastern*. In response, the district court certified to the Tenth Circuit the following question for interlocutory appeal:

> In a private antitrust action under 15 U.S.C. § 15 involving claims of price fixing against the producers of natural gas, is a State a proper plaintiff as *parens patriae* for its citizens who paid inflated prices for natural gas, when the lawsuit already includes as plaintiffs those public utilities who paid the inflated prices upon direct purchase from the producers and who sub-

sequently passed on most or all of the price increase to the citizens of the State?

Pet. App. A41.

3. The court of appeals answered the certified question in the negative. In the court of appeals' view, the reasoning of *Hanover Shoe* and *Illinois Brick* requires that the cost-plus exception—if there is one[2]—be limited to cases involving a pre-existing contract for a fixed quantity. Pet. App. A8. In the absence of a fixed quantity provision, the court reasoned, the utilities would presumably suffer injury from the decreased demand for natural gas resulting from the higher price even if they passed on the entire overcharge. Pet. App. A12-A13. Consequently, it would still be necessary to apportion damages between the direct and indirect purchasers, were the latter permitted to recover. Pet. App. A14. The court of appeals accordingly concluded that even if there were "a perfect and provable pass-on of the allegedly illegal overcharge" in this case, *ibid.*, the cost-plus exception would not apply.

In the meantime, the en banc Seventh Circuit had reached a contrary conclusion in *Illinois* v. *Panhandle Eastern Pipe Line Co.*, 852 F.2d 891 (en banc), cert. denied, 109 S. Ct. 543 (1988). The Tenth Circuit, however, expressly declined "to apply the law as enunciated in *Panhandle Eastern*." Pet. App. A13.

## DISCUSSION

The existence and scope of any cost-plus exception to the rule precluding antitrust damage suits by indirect purchasers is a recurring question of substantial importance. Uncertainty regarding who may recover an illegal overcharge

[2] The court noted that this Court did not say that a pre-existing cost-plus contract for a fixed quantity "would constitute an exception but rather that it 'might be.' " Pet. App. A8.



undermines the rationale of the *Illinois Brick/Hanover Shoe* rule, which is intended to curtail litigation on that issue and enhance the deterrent value of the treble damage remedy. The court of appeals' construction of the cost-plus exception in this case conflicts squarely with the Seventh Circuit's construction in *Panhandle Eastern*. Accordingly, we urge the Court to grant the petition and clarify the scope of the exception.

We have initiated a comprehensive review of the complex legal and policy questions implicated by this issue among the agencies charged with enforcing the antitrust laws. Although that review is not yet complete, we are convinced that resolution of this troubling issue by this Court would be of substantial benefit to the antitrust litigants, the courts, and the public.

1. In *Hanover Shoe*, this Court—in a case in which the plaintiff claimed damages in the amount of an unlawful monopoly overcharge—rejected the asserted defense that the buyer had passed on the overcharge to its customers. The Court was unwilling to recognize an exception to the established principle that a buyer who has paid an overcharge is injured in the amount of the overcharge "[e]ven if it could be shown that the buyer raised his price in response to, and in the amount of, the overcharge and that his margin of profit and total sales had not thereafter declined." 392 U.S. at 493. It reasoned that permitting the defense that the overcharge was passed on would result in "normally • • • insurmountable" evidentiary problems and "additional long and complicated proceedings," *ibid.*, to establish the effect of an unlawful overcharge on a middleman's prices and profits. Moreover, the Court observed, permitting the defense might leave only ultimate consumers as potential plaintiffs, and yet individual consumers "would have only a tiny stake in a lawsuit and little interest in attempting a class action." *Id.* at 494. Consequently,

"[t]reble-damage actions, the importance of which the Court has many times emphasized, would be substantially reduced in effectiveness," *ibid.*, in deterring violations of the antitrust laws. Notwithstanding its articulated reservations about the wisdom of allowing a pass-on defense, the Court nonetheless recognized that there "might" be situations in which such a defense would be permitted, "for instance, when an overcharged buyer has a pre-existing 'cost-plus' contract, thus making it easy to prove that he has not been damaged." *Ibid.*

In *Illinois Brick*, an indirect purchaser sought to recover overcharges allegedly passed on to it by a direct purchaser from alleged antitrust violators. The Court held that the rule of *Hanover Shoe* applied equally to this "offensive" use of pass-on in litigation, in large measure because "allowing offensive but not defensive use of pass-on would create a serious risk of multiple liability for defendants." 431 U.S. at 730. Moreover, the Court concluded that the complexity and enforcement rationales of *Hanover Shoe* applied to offensive as well as defensive uses of the pass-on contention.[3] The Court recognized that concentrating the entire recovery in the direct purchaser might leave indirect purchasers without compensation even where they had in fact been injured by an overcharge. But it expressed considerable doubt that permitting indirect purchasers to sue for damages would lead to a recovery accurately reflecting the injury suffered.[4]

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[3] The Court observed that "direct purchasers sometimes may refrain from bringing a treble-damages suit for fear of disrupting relations with their suppliers," 431 U.S. at 746, but nevertheless concluded that on balance enforcement objectives would be better served by treating direct purchasers as bearing the entire overcharge than by attempting to apportion that overcharge.

[4] The Court noted that indirect purchasers with a small stake in a lawsuit might not come forward even in a class action. 431 U.S. at 747 & n.31.



The Court in *Illinois Brick* generally rejected "attempts to carve out exceptions to the *Hanover Shoe* rule for particular types of markets," 431 U.S. at 744, observing that "the process of classifying various market situations according to the amount of pass-on likely to be involved and its susceptibility to proof in a judicial forum would entail the very problems that the *Hanover Shoe* rule was meant to avoid," *id.* at 744-745. It did, however, refer to the suggestion in *Hanover Shoe* that there might be an exception for pre-existing cost-plus contracts, explaining that "[i]n such a situation, the purchaser is insulted from any decrease in its sales as a result of attempting to pass on the overcharge, because its customer is committed to buying a fixed quantity regardless of price" so that "[t]he effect of the overcharge is essentially determined in advance, without reference to the interaction of supply and demand." *Id.* at 736.[5] Thus, although the Court has never held that there is an exception to the pass-on rule for situations involving pre-existing cost-plus, fixed quantity contracts, it has suggested that such an exception exists.[6]

2. The Court's dicta suggesting the existence of a cost-plus exception have led to conflict in the circuits concerning the scope of the exception. In particular, the Tenth Cir-

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[5] To the extent that a direct purchaser deals with indirect purchasers pursuant to a preexisting cost plus contract for a fixed quantity, the direct purchaser presumably is fully compensated by the indirect purchasers for his payment of an illegal overcharge and loses no profits as a result of declining sales volume.

[6] The Court's most recent reference to this possible exception in *California* v. *Arc American Corp.*, 109 S. Ct. 1661, 1663 n.2 (1989), contains no reference to the fixed quantity component of the exception, citing a footnote in *Illinois Brick*, 431 U.S. at 732 n.12, which in turn refers to the Court's earlier discussion in *Hanover Shoe*. The fixed quantity requirement was not explicitly mentioned in *Hanover Shoe*; it was first articulated in *Illinois Brick* itself.

cuit in this case and the Seventh Circuit in *Panhandle Eastern* have come into square conflict with respect to the necessity of a fixed quantity provision.

*Panhandle Eastern*, like this case, involved natural gas purchased by a utility from a pipeline at prices allegedly inflated by antitrust violations and then resold by the utility to its customers at prices affected by the overcharge. The State of Illinois brought suit on behalf of the utility's customers to recover the passed-on overcharge.[7] The pipeline moved to dismiss Illinois's suit, citing the pass-on rule. The district court denied the motion, but certified the issue for interlocutory appeal. The en banc court unanimously ruled that the utility's industrial purchasers could not sue, but in a divided ruling (six to four) permitted residential customers of the utility to sue.

The Seventh Circuit reasoned that "there is no indication that by using the words 'fixed quantity' the Supreme Court meant to address the issue of the status of regulatory cost-plus pricing." Pet. App. A47. The utility in the case before the Seventh Circuit was required by statute to sell, and did sell, gas subject to a contractual provision requiring it to pass on the full amount of the alleged overcharge to residential customers.[8] There was no fixed quantity provision, but

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[7] The utility subsequently also filed suit.

[8] The court noted that it was conceivable that but for the overcharge the utility would have sought and obtained a rate increase and, therefore, that the pass on might not in fact have been complete. It deemed this possibility too insignificant to affect its conclusion, however. Pet. App. A59.

Gas sold to industrial customers was subject to the same contractual provision but, because industrial customers had alternatives to natural gas, the responsiveness of demand to price increases was greater than that of residential customers. The utility therefore sought, and obtained, regulatory permission not to pass the entire amount of the overcharge on to industrial customers. Pet. App. A52.



the Seventh Circuit apparently understood the fixed quantity requirement mentioned by this Court in *Illinois Brick* as intended primarily to assure that the full overcharge would be passed on.[9] Regulation that holds price below the profit-maximizing price, the court reasoned, provides similar assurance, thus rendering the fixed quantity requirement unnecessary. *Id.* at A50-A51.[10] The court acknowledged, however, that although the regulatory context might provide assurance that the overcharge would be fully passed on and make proof of the amount of the injury incurred by indirect residential customers "straightforward," *id.* at A55, it would not preclude injury to the utility resulting from loss of sales at the higher price. Accordingly, the court concluded that the indirect residential customers could recover damages for the overcharge, while the utility could recover damages resulting from lost sales, *id.* at A54, as well as for the overcharge on gas sold to industrial customers.

On similar facts,[11] the Tenth Circuit concluded that only the direct purchaser could sue, flatly rejecting *Panhandle Eastern*, Pet. App. A15, and pointing to "the issue of

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[9] As previously noted, however, the fixed quantity provision would also insulate the direct purchaser against the risk of lost sales resulting from a price increase. See note 5, *supra*.

[10] The court apparently viewed requirements contracts as providing similar assurance, using such contracts to illustrate why "a rigid test of fixed quantity would be a senseless limitation on the cost-plus exception." Pet. App. A57.

[11] The Tenth Circuit "distinguish[ed] the facts" of *Panhandle Eastern* from those in this case, Pet. App. A13, but not persuasively. As it observed, *id.* at A14, the most important difference between the two cases relates to the likelihood of a complete pass on of the overcharge, a difference which cannot have affected the result because of the Tenth Circuit's assumption that there was a "perfect and provable pass-on." *Ibid.*

decreased demand due to higher prices," *Id.* at App. A14, as a primary reason for its conclusion. In the Tenth Circuit's view, "[i]f we were to adopt the reasoning of *Panhandle Eastern*, we would in reality be carving out yet another exception • • • to the basic rule that only a direct purchaser may sue for the antitrust violation." *Id.* at A15. The holdings of the Tenth and Seventh Circuits cannot be reconciled.[12]

Nor can this case be reconciled with the Fifth Circuit's disposition of the fixed quantity requirement in *In re Beef Industry Antitrust Litigation*, 600 F.2d 1148, 1164 (1979), cert. denied, 449 U.S. 905 (1980). There the court treated overcharge damages and lost profits due to diminished volume resulting from an overcharge as "wholly separable items of damage," implying that separate suits could be maintained. Thus, at least one panel of the Fifth Circuit appears to share the Seventh Circuit's view of the fixed quantity requirement.[13] The Seventh Circuit, however, characterized the *Beef Industry* formulation as "requir[ing] elaborate analysis of the incidence of a cost increase, which is precisely the analysis that the Court disparaged in *Illinois Brick*," Pet. App. A48, because, in the Seventh Circuit's view, the Fifth Circuit would apply the exception even in the absence of a cost-plus contract, so long as pricing practices in the market constitute the "functional equivalent" of such a contract.

[12] The Sixth Circuit has also declined to follow *Panhandle Eastern*'s analysis of the fixed quantity requirement, *County of Oakland* v. *City of Detroit*, 866 F.2d 839, 854 (1989) (order denying rehearing), petition for cert. pending, Nos. 89-56, 89-79 and 89-101, in a case involving somewhat different facts. We have filed a brief as amicus curiae in *Allevato* urging the Court to hold those petitions pending the Court's disposition of this case.

[13] An earlier case in the Fifth Circuit had reached a different result. *Yoder Bros.* v. *California-Florida Plant Corp.*, 537 F.2d 1347, 1375-1376 (1976), cert. denied, 429 U.S. 1094 (1977), held that the exception required a showing that the direct purchaser suffered no loss of sales from a higher price.



3. Whether an exception to the rule of *Hanover Shoe* and *Illinois Brick* should be fashioned to take account of the possibility that the direct purchaser may suffer no injury at all and, if so, what limits should be placed on that exception to prevent it from undermining the purposes of the rule, are difficult questions. Answering them requires consideration of the three fundamental and interrelated policy goals identified by this Court: (1) preventing undue complication of antitrust litigation; (2) providing compensation to victims of antitrust violations; and (3) maintaining the treble damage remedy as an effective deterrent to antitrust violations.

Recognizing an exception to the fundamental rule prohibiting proof of a pass-on would inevitably complicate antitrust litigation to some extent, as there would always be potential for litigation about the applicability of the exception in particular circumstances. The risk of complicating litigation would be more significant if the exception encompassed more than preexisting cost-plus contracts providing for a fixed quantity. In particular, dispensing with the requirement of a fixed quantity and allowing indirect purchasers to claim the overcharge while at the same time allowing direct purchasers to claim damages for lost profits attributable to lost sales, would add additional parties to the litigation and could present potentially difficult issues about whether lost sales are attributable to higher charges or to some other factor.[14]

[14] Even more complex litigation would be engendered by a formulation allowing the parties to litigate the extent to which the overcharge actually was passed on, as opposed to a formulation focusing exclusively on the existence of a legally binding provision providing for a complete pass on. We note that the Seventh Circuit viewed proof of the indirect purchasers' loss as "straightforward" in a regulatory context,

On the other hand, an exception where overcharges are fully passed on would probably increase compensation for injured parties. As the Court has noted, the *Hanover Shoe* rule "does further the goal of compensation to the extent that the direct purchaser absorbs at least some and often most of the overcharge." *Illinois Brick*, 431 U.S. at 746. Nevertheless, it seems clear that one consequence of the rule is that at least some indirect purchasers that suffer actual injury will be left uncompensated. Thus, to the extent that no regulatory or other mechanism requires the direct purchaser to pass on the recovery of antitrust damages to indirect purchasers, recognition of an exception allowing indirect purchasers to recover directly where they alone suffer injury would plainly serve the purpose of compensation. Moreover, even if there are regulations requiring direct purchasers to pass on antitrust damages to customers, those regulatory mechanisms, like the litigation mechanisms for recovery by numerous injured parties, may work imperfectly. Conversely, of course, if an exception were recognized for cost-plus contracts and only indirect purchasers are allowed to recover (to avoid the problem of increased complexity and litigation costs), direct purchasers could be left uncompensated.

Finally, an exception could affect the incentives of private plaintiffs—and thus the deterrent value of the remedy—in a variety of ways. As this Court observed in *Illinois Brick*, 431 U.S. at 745-746, dividing the recovery among many potential plaintiffs may dilute the incentive to sue, and therefore undermine the deterrent effect of the treble damage remedy.[13] On the other hand, a direct purchaser

Pet. App. A55, while the Tenth Circuit, on somewhat different facts, rejected petitioners' contention that such proof would be simple, Pet. App. A11-A12.

[13] *Parens patriae* actions, such as this one, may to some extent avoid the problem of multiple potential plaintiffs. However, the states may



who has a cost-plus contract presumably suffers less injury from an antitrust violation than other types of direct purchasers, and thus has less incentive to sue. Similarly, if direct purchasers are required either by regulation or contractual provisions to pass on antitrust recoveries to their customers, they may have a reduced incentive to sue. Compare Pet. App. A50-A51 (public utility commission may force utility to pass recovery on to consumers, leaving utility with no incentive to sue), with Pet. App. A11 (utilities must believe there is benefit in pursuing these actions).

Our review of these policy considerations is ongoing. If the Court grants the petition, we anticipate that we will file a brief discussing the appropriate scope of the cost-plus exception, taking into account each of the foregoing factors.

sue as *parens patriae* only on behalf of natural persons. Moreover, states may face resource constraints that would limit their ability to bring such actions.

## CONCLUSION

The petition for a writ of certiorari should be granted.
Respectfully submitted.

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